Notes

DETERMINATION AND PAYMENT OF EQUITY RECEIVERSHIP COSTS AFTER SUPERSEDING BANKRUPTCY

A BANKRUPTCY proceeding within four months of the appointment of an equity receiver operates to give the bankruptcy court power to procure the assets of the bankrupt held by the receiver.[1] However, it is not settled that the bankruptcy court has power to prevent the receivership court from determining the receivership costs[2] and, assuming a lack of this power, to prevent the payment of these costs by the receivership court. In a recent case[3] a receiver for an insolvent corporation was appointed by the Federal District Court for the Southern District of California. Within four months of the appointment of the receiver an involuntary petition in bankruptcy was filed against the corporation in the same court sitting in bankruptcy. Despite the opposition of the trustee the court, sitting in equity,[4] accepted the account and fixed the compensation of the receiver. On appeal, the Court of Appeals for the 6th Circuit held that the District Court was without jurisdiction to make such an order, and directions were given to consider the application while sitting as a court of bankruptcy.

Early state decisions held that a state receiver should receive his compensation before the assets were delivered to the trustee in bankruptcy.[5] And the Supreme Court by way of dictum in *In Re Watts & Sachs*[6] added

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[1] In re Diamond's Estate, 259 Fed. 70 (C. C. A. 6th, 1919); In re Williams, 240 Fed. 788 (N. D. Ohio 1917). The most widely cited case is In re Watts & Sachs, 190 U. S. 1, 23 Sup. Ct. 718 (1903) (involved an assignee for the benefit of creditors). For cases denying the power where the petition was more than four months after the appointment of the receiver, see Hoover v. Mortgage Co., 290 Fed. 891 (C. C. A. 9th, 1923) (federal receivership); Blair v. Brailey, 221 Fed. 1 (C. C. A. 5th, 1915) (state receiver). But *cf.* In re Weedman Stave Co., 199 Fed. 948 (E. D. Ark. 1912) (receiver appointed under state insolvency statute declared void).

[2] Including fees of the receiver and his counsel and receivership costs.

[3] Moore v. Scott, 55 F. (2d) 863 (C. C. A. 9th, 1932).

[4] In the order of adjudication the District Court reserved to itself as an equity court the hearing of the accounts and the determination of the fees of the receiver and his counsel. Adjudication did not follow the petition for almost two years during which time the receiver continued to administer the estate.

[5] Mauran v. Crown Carpet Lining Co., 23 R. I. 344, 50 Atl. 387 (1901); Wilson v. Parr, 115 Ga. 629, 42 S. E. 5 (1902). But *cf.* Hanson v. Stephens, 116 Ga. 722, 42 S. E. 1028 (1902). The Georgia cases are distinguished on the grounds that in the former case there was cash available for payment of receivership costs while in the latter a sale of property was necessary which was beyond the power of the receivership court. For a suggestion that this distinction will be made in the federal courts see Hume v. Myers, 242 Fed. 827, 830 (C. C. A. 4th, 1917).

[6] *Supra* note 1, at 35, 23 Sup. Ct. at 727. "It remains for the state court to transfer the assets, settle the accounts of its receiver, and close its connection with the matter."

weight to these rulings by suggesting that although the jurisdiction of the bankruptcy court was exclusive, nevertheless the state court should wind up its receivership before turning over the assets to the trustee. This dictum has been followed by a majority of state courts which have passed upon the question.[7] But in a dictum in *Lion Bonding & Surety Co. v. Karatz*[8] Mr. Justice Brandeis expressed a contrary view and the citation of the dictum of the *Watts* case in a note as "compare" may indicate that it has been discountenanced. Moreover, a majority of federal decisions hold the receiver accountable to the bankruptcy court.[9] And where the receivership court is allowed to fix the compensation of its receiver it is not permitted to impress a lien upon the assets[10] and its decision is subject to review by the bankruptcy court.[11]

A summary order by the bankruptcy court requiring the receiver to turn over the assets is available[12], but the better practice is for the trustee to apply to the receivership court for an order directing the receiver to deliver the property.[13] In New Jersey, however, the courts have uniformly affirmed the power of the receivership court to fix and pay the compensation of its receiver and have refused to turn over the assets till payment has been made.[14] They have further indicated that an application by their receiver to the bankruptcy court for compensation would be in contempt of the state court[15] and have expressed their disapproval of a suggestion that a failure to turn over all the assets to the trustee would put the receiver in contempt of the federal court.[16] In a recent case[17] the Federal District Court for New Jersey, criticising the New Jersey decisions, held that the state court was without jurisdiction to fix the compensation of its receivers. But the New Jersey court has refused to follow this ruling until the Supreme Court

[7] 1st National Bank of Quincy v. Zangwell, 61 Fla. 596, 54 So. 375 (1911) (power of state court not attacked but fees allowed); McGahee v. Cruickshank, 133 Ga. 649, 66 S. E. 776 (1909); Lambert v. National Hog Co., 263 Pa. 354, 106 Atl. 541 (1919); cases cited *infra* note 14; see State v. German Exchange Bank, 114 Wis. 436, 90 N. W. 570 (1902) (held a matter of administrative discretion and the receiver advised to apply to state court for determination of fees and federal court for payment, though implied that claim would constitute lien). *Contra:* Bloch v. Block, 42 Misc. 278, 86 N. Y. Supp. 1047 (1903).

[8] 262 U. S. 640, 642, 43 Sup. Ct. 641, 642 (1923).

[9] In re Diamond's Estate, *supra* note 1; In re Standard Fuller's Earth Co., 186 Fed. 578 (S. D. Ala. 1911). *Contra:* Loveless v. Southern Grocer Co., 159 Fed. 415 (C. C. A. 5th, 1908).

[10] In re Standard Fuller's Earth Co., *supra* note 9; In re Rogers, 116 Fed. 435 (S. D. Ga. 1902).

[11] In re Moore, 42 F. (2d) 475 (N. D. Ga. 1930); Hume v. Myers, *supra* note 5.

[12] In re Moore, *supra* note 11; Gamble v. Daniel, 39 F. (2d) 447 (C. C. A. 8th, 1930).

[13] In re Williams, *supra* note 1; In re Lingert Wagon Co., 110 Fed. 927 (S. D. N. Y. 1901).

[14] Perfection Garment Co. v. Crosly Stores Inc., 109 N. J. Eq. 450, 158 Atl. 380 (1932); Singer v. National Bedstead Mfg. Co., 65 N. J. Eq. 290, 25 Atl. 868 (1903).

[15] Colton v. Bankshares Corp. of United States, 108 N. J. Eq. 417, 418, 155 Atl. 471 (1931).

[16] *Id.* at 418, 155 Atl. at 471, cited with approval in Moore Co. v. Federal Metal Bed Co., 159 Atl. 698 (N. J. Ch. 1932).

[17] Silberberg v. Ray Chain Stores Inc., 54 F. (2d) 650 (D. N. J. 1931).

has passed upon the question.[18] In this situation only an appeal to that court can determine the conflict, although the *Lion Bonding* case makes it likely that the federal court will be upheld.

As a matter of administration the equity court would seem better qualified to pass on the costs of its own receivership, and comity would suggest that it should be allowed to do so even though its decision be subject to review by the bankruptcy court. The more important aspect of the conflict, and the only one where the same judge presides in both courts, is a possible difference in the preferential treatment accorded receivership claims. While in the receivership court receivership costs would be preferred to other classes of creditors,[19] it is possible that they will only be preferred in the bankruptcy court to the extent to which they were of benefit in preserving the estate.[20] In *In re Quemahoning Creek Coal Co.*[21] the court indicated that receivership costs should be preferred to mortgage creditors, but in that case it was found that the mortgage holders had consented to the receivership and so could not complain of the preference granted the receiver. In an earlier case [22] it was held that the receivership costs should be prior to administration costs and taxes, but it was assumed that the receivership was necessary for the preservation of the estate. On the other hand, the fees of an attorney opposing the bankruptcy proceedings have not been allowed.[23] because of no benefit to the estate. And in one case the receiver was limited to compensation for services which were performed after the petition,[24] the suggestion being made that the receiver should sue the plaintiff in the state action to recover compensation for the period prior to the filing of the petition. These decisions bear on the problem, but because of distinguishing facts afford no sound basis for an accurate prediction as to the priority to be granted all receivership costs by bankruptcy courts.[25]

If receivership costs are not granted priority, particularly as in the instant case where the receivership extended over a considerable period of time, injustice will be done to the receiver who gave his services on the strength of the authority of the receivership court at the time of his appointment. Again, if it were probable that bankruptcy within four months would avoid the preferences granted under the receivership, difficulty would

[18] Perfection Garment Co. v. Crosly Stores Inc., *supra* note 14.

[19] Kennebec Box Co., Inc. v. O. S. Richards Corp., 5 F. (2d) 951 (C. C. A. 2d, 1925); Cambell v. Nichols, 145 Wash. 614, 261 Pac. 408 (1927). See MINN. STAT. (Mason, 1927) § 8013; IOWA CODE (1927) § 12719. *Cf.* NEW YORK LAWS (1929) c. 650, §§ 180, 181.

[20] Receivership expenses are granted as a priority when they are incurred as a necessary step in the preservation of the estate. In re Chase, 124 Fed. 753 (C. C. A. 1st, 1903) (an assignee for the benefit of creditors under a state statute); see Rand Randolph v. Scruggs, 190 U. S. 533, 539, 23 Sup. Ct. 710, 712, 713; In re Rogers v. Stefani, 156 Fed. 267, 269 (W. D. Ark. 1907). See BANKRUPTCY ACT, § 64 b (1). This section does not make a provision for services rendered before filing of the petition and no authority is given in the act for such a priority. See also In re Board of Directors of Suburban Construction Co., 143 N. Y. Supp. 363 (Sup. Ct. 1913) (attorney who procured receivership treated as unsecured creditor, but receiver granted a priority).

[21] 15 F. (2d) 58 (W. D. Pa. 1926).

[22] Pain v. Arch, 233 Fed. 259 (C. C. A. 9th, 1916).

[23] In re Zier & Co., 127 Fed. 399 (D. Ind. 1904), *aff'd*, 142 Fed. 102 (C. C. A. 7th, 1905).

[24] In re J. H. Alison Lumber Co., 137 Fed. 643, 647 (S. D. Ga. 1905).

[25] See also In re Rogers, 116 Fed. 435, 437 (S. D. Ga. 1902); In re Lengert Wagon Co., 110 Fed. 927, 928 (S. D. N. Y. 1901).

be encountered in obtaining the necessary credit to carry on a business in receivership. Receivership certificates and materialmen's claims would be at a discount till the four months' period was safely past. Only if priority be given receivers' costs by the bankruptcy court, can the effect of the holding in the principal case be limited to delay and added expense.

TAXATION OF FEDERAL AND STATE INSTRUMENTALITIES

WITHIN the past year the Supreme Court has shown a decided change in attitude toward the doctrine that neither the state nor the federal government may tax the instrumentalities of the other.[1] Traditionally, it was said that the principle rested upon an "entire absence of power," [2] and the exemption, absolute in its application,[3] was extended to corporate and individual income even remotely related to such functions. Thus in *Pandandle Oil Co. v. Knox*,[4] a state excise tax was held unconstitutional so far as it affected sales made by a private company to the Coast Guard Fleet. In *Gillespie v. Oklahoma*,[5] oil obtained by a private lessee of lands granted by the government to the Indians, was declared not to be subject to a nondiscriminatory state tax on minerals. And in *Long v. Rockwood*[6] it was held that royalties from licenses under federal patents could not be included in the computation of net income for the purposes of a state franchise tax. Four cases in the last year have demonstrated a complete departure from these decisions.[7] In *Willcuts v. Bunn*,[8] the federal income tax was declared properly applicable to profits gained by an individual from the sale of state bonds. In *Susquehanna Power Co. v. State Tax Commission*,[9] submerged

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land owned by a corporation building a dam in which the federal government had an interest, was held subject to state land taxes. In *Group No. 1*

[1] McCulloch v. Maryland, 4 Wheat. 316 (1819); Ambrosini v. United States, 187 U. S. 1, 23 Sup. Ct. 1 (1902).

For a history and critique of the doctrine, see: Powell, *Indirect Encroachment on Federal Authority* (1918) 31 HARV. L. REV. 321; Powell, *The Macallen Case—and Before* (1930) 8 NAT. INC. TAX MAG. 47; and Powell, *An Imaginary Judicial Opinion* (1931) 44 HARV. L. REV. 889.

[2] Johnson v. Maryland, 254 U. S. 51, 55, 41 Sup. Ct. 16 (1920).

[3] Gillespie v. Oklahoma, 257 U. S. 501, 505, 42 Sup. Ct. 171, 172 (1921).

[4] 277 U. S. 218, 48 Sup. Ct. 451 (1928).

[5] *Supra* note 3. See also: Choctaw, Oklahoma & Gulf Ry. Co. v. Harrison, 235 U. S. 292, 35 Sup. Ct. 27 (1914); Indian Oil Co. v. Oklahoma, 240 U. S. 522, 36 Sup. Ct. 453 (1916); Jaybird Mining Co. v. Weir, 271 U. S. 609, 46 Sup. Ct. 592 (1926).

[6] 277 U. S. 142, 48 Sup. Ct. 463 (1928).

[7] Discussion of Educational Films Corp. v. Ward, 282 U. S. 379, 51 Sup. Ct. 170 (1931) and Pacific Co. v. Johnson, 52 Sup. Ct. 424 (U. S. 1932) is omitted, because the acts there involved were sustained mainly upon the basis of the "subject" test, whereby franchise taxes are declared invalid if, in their operation, they affect federal instrumentalities, Macallen v. Massachusetts, 279 U. S. 620, 49 Sup. Ct. 432 (1929); Miller v. Milwaukee, 272 U. S. 713, 47 Sup. Ct. 280 (1927); and valid if tax exempt sources are used only as the "measure" of the value of the license. Home Insurance Co. v. New York, 134 U. S. 594, 10 Sup. Ct. 593 (1890); Flint v. Stone Tracy Co., 220 U. S. 107, 31 Sup. Ct. 342 (1911). See: Isaacs, *The Subject and Measure of Taxation* (1926) 26 COL. L. REV. 939; (1931) 44 HARV. L. REV. 829; and (1931) 40 YALE L. J. 826.

[8] 282 U. S. 216, 51 Sup. Ct. 125 (1931).

[9] 283 U. S. 291, 51 Sup. Ct. 434 (1931).

land owned by a corporation building a dam in which the federal government had an interest, was held subject to state land taxes. In *Group No. 1 Oil Company v. Bass*,[10] the federal income tax was sustained in so far as it affected income from gas and oil obtained by the lessee of lands granted by a state to its University. And most recently, in *Fox Film Corporation v. Doyal*,[11] royalties received by the petitioner from the licensing of copyrighted motion picture films were refused exemption from a state tax[12] measured by gross receipts. In the *Fox Film* case, the court pointed out that the sole interest of the government in copyrights was the securing of a monopoly to the holder, and that a tax on the royalties could not possibly interfere with the protection thus afforded. Hence, the mere fact that a copyright was property derived from a grant by the United States was declared insufficient to support the claim of exemption. Inasmuch as the conclusion reached was said to apply with equal force to patents, *Long v. Rockwood* was definitely overruled.[13]

The point of view expressed by the court in these cases is persuasive. "In a broad sense, the taxing power of either government, even when exercised in a manner admittedly necessary and proper, unavoidably has some effect upon the other."[14] But, "the power to tax is no less essential than (for example) the power to borrow money."[15] Therefore, "the exemption of an instrumentality of one government from taxation by the other must be given such a practical construction as will not unduly impair the taxing power of the one or the appropriate exercise of its functions by the other."[16]

This method of approach is diametrically opposed to the traditional view that the question is "one of power and not of practical results."[17] However, it would be too much to expect that the venerable premises of former opinions should have been abandoned altogether. Indeed, twice within the past year, the court has rested decisions directly upon them.[18] The *Fox Film* case is the first in which the Court has specifically overruled a prior decision on this question.[19] And even here Mr. Chief Justice Hughes, in an extremely

[10] 283 U. S. 279, 51 Sup. Ct. 432 (1931).

[11] U. S. Daily, May 18, 1932, at 524.

[12] GA. CODE ANN. (Michie, Supp. 1930) § 993 (316)–(341). Because the measure of the tax was gross receipts instead of net income, the court felt bound to declare that the tax was imposed directly upon the royalties. *Cf.* Northwestern Mutual Life Insurance Co. v. Wisconsin, 275 U. S. 136, 141, 48 Sup. Ct. 55, 56 (1927); Crew Levick Co. v. Pennsylvania, 245 U. S. 292, 297, 38 Sup. Ct. 126, 128 (1917); United States Glue Co. v. Oak Creek, 247 U. S. 321, 328, 38 Sup. Ct. 499, 501 (1918). Educational Films v. Ward, *supra* note 7, was said not to be controlling, because there the tax was measured by net income.

[13] *Supra* note 11, at 525.

[14] Metcalf & Eddy v. Mitchell, 269 U. S. 514, 523, 46 Sup. Ct. 172, 174 (1926).

[15] Willcuts v. Bunn, *supra* note 8 at 225, 51 Sup. Ct. at 127.

[16] Susquehanna Power Co. v. State Tax Commission, *supra* note 9, at 294, 51 Sup. Ct. at 435.

[17] Commonwealth v. Westinghouse Manufacturing Co., 151 Pa. 265, 270, 24 Atl. 1107, 1109 (1892).

[18] Indian Motocycle Co. v. United States, 283 U. S. 570, 51 Sup. Ct. 601 (1931) was held to be ruled by the Panhandle case, *supra* note 4, and Burnet v. Coronado Oil & Gas Co., 52 Sup. Ct. 443 (U. S. 1932) by the Gillespie case, *supra* note 3.

[19] Willcuts v. Bunn, *supra* note 8, Susquehanna Power Co. v. State Tax Commission, *supra* note 9, and Group No. 1 Oil Corp. v. Bass, *supra* note 10, managed to distinguish conflicting opinions.

cautious opinion, narrowed the issue to a point where only *Long v. Rockwood* had to be discarded.[20]

The present tendency of the court, therefore, has not yet been carried to its logical conclusions. Nevertheless, the decision in the *Fox Film* case is at least economically sound. For the rising cost of state and local government, enhanced by widespread unemployment, and accompanied by a decrease in the traditional sources of revenue, indicates that new fields for taxation must be found. Moreover, there is now ground for the hope that in the future all income claiming exemption as a federal instrumentality, perhaps even the thirty billion dollars invested in tax exempt securities,[21] will have to prove by facts as to actual consequences, instead of leaving the decision to the inadequate guidance of judicial notice,[22] that their inclusion in a state or federal tax would cast any appreciable burden on either government's borrowing power.

The way to the final step in this direction was suggested by Mr. Justice Brandeis in his separate opinion in *Burnet v. Coronado Oil & Gas Co.*[23] He pointed out that the validity of a given tax depends not upon a proposition of law, but wholly upon the determination of the *fact* whether, in the particular instance, an objectionable burden is imposed upon the execution of a governmental function—and questions of fact need not be fettered by *stare decisis*.[24]

RELEASE OF LESSEE BY AGREEMENT BETWEEN LESSOR AND ASSIGNEE OF LEASE

THE Winchester Repeating Arms Co., lessee, transferred its entire interest in the term to the Bayshore Co., which paid the rent direct to the lessor, the latter consenting to the transfer. Thereafter, the Winchester Co. passed into receivership. On notification by the receivers that they "canceled the lease and renounced all further liability of the Winchester Co. thereto," the tenant Bayshore Co., considering itself released, paid the rent to date and vacated. The lessor, having notified all parties that it would take possession of the premises without releasing them from liability, executed a new lease to the Bayshore Co. for the remainder of the term at reduced rental. Thus far, all parties had assumed that the Bayshore Co. originally held as sublessee. But in the receivership proceedings, the transfer was

[20] The problem was stated thus: "Where the immunity exists, it is absolute, resting upon 'an entire absence of power,' Johnson v. Maryland, 254 U. S. 51, 55, 56, but it does not exist 'where no direct burden is laid upon the governmental instrumentality, and there is only a remote, if any, influence upon the exercise of the functions of government.' Willcuts v. Bunn, 282 U. S. 216, 225." *Supra* note 11. Obviously the exception swallows the rule. But the dictum did provide a way to distinguish the Gillespie case and the Coronado case.

[21] Seligman, *Toward a New Tax Program* (1932) 134 THE NATION 484, 486.

[22] Willcuts v. Bunn, *supra* note 8, at 230, 51 Sup. Ct. at 129.

[23] *Supra* note 18.

[24] "The decision of the court, if, in essence, merely the determination of a fact, is not entitled, in later controversies between other parties, to that sanction which, under the policy of *stare decisis*, is accorded to decisions of a proposition purely of law. For not only may the decision of the fact have been rendered upon an inadequate presentation of the existing conditions, but the conditions may have changed meanwhile . . ." Burnet v. Coronado Oil & Gas Co., *supra* note 18, at 449.

held to have been an assignment [1] resulting in the assignor's becoming surety for payment of the rent by the assignee.[2] The court deduced therefrom that the new agreement, not containing any reservation of rights against the surety, constituted a release rendering void the lessor's claim for damages in the receivership.[3]

The stated basis for this result is that the creditor made a "wholly new contract with the principal" [4] which discharged the surety. But implicit in this suretyship rule is the assumption that the new agreement constituted a contract. Thus an agreement invalid for want of consideration will not release the surety.[5] And it is settled law of landlord and tenant that the mere promise of the lessor to reduce the rent is *nudum pactum*.[6] The second lease of the instant case apparently amounted to no more.[7] The lessee Bayshore Co. merely promised to perform its preexisting obligations in return for a reduction of over seven thousand dollars yearly rental. Nor should the inclusion of new covenants by the lessee in the second lease suffice to validate it in a court of equity, inasmuch as they were obviously not regarded as the equivalent of the substantial reduction in rent. Moreover, the rationale of the maxim *strictissime jure* as applied to a gratuitous surety is entirely lacking in the case of an assignor of a lease, since the fact of his becoming a surety is but an incident of the self-serving act of assignment.[8] If, therefore, the lessee was not discharged on the original lease, the Winchester Co.'s right of subrogation as surety remained unimpaired.

The court further refused to consider as a basis for allowance of the claim, the repudiation of the suretyship obligation by the receivers, which antedated the vacating by the Bayshore Co. Although recognizing the doctrine of anticipatory breach as giving a provable claim in receivership, the court excluded from its application a repudiation by the surety. But such a distinction seems unwarranted, especially in view of the recent case of *Maynard v. Elliott* [9] in which the Supreme Court allowed such a claim in bankruptcy. And the restrictions on proof of claims reasonably should not be more severe in receivership than in bankruptcy. If then, the Winchester Co.'s obligations on the lease had become a liability to damages, it is arguable that the subsequent alleged release of the principal was without effect.

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[1] A transfer, as in this case, which leaves no reversion in the original lessee, results in an assignment. 1 TIFFANY, REAL PROPERTY (1920) 170.

[2] Collins v. Pratt, 181 Mass. 345, 63 N. E. 946 (1902); Realty and Rebuilding Co. v. Rea, 45 Cal. App. 673, 188 Pac. 621 (1920).

[3] T. A. D. Jones Co. v. Winchester Repeating Arms Co., 55 F. (2d) 944 (D. Conn. 1932). The facts stated herein are simplified.

[4] *Supra* note 3, at 948.

[5] Vanderbeck v. Tierney-Connolly Construction Co., 77 N. J. L. 664, 73 Atl. 480 (1909); Dodd v. Vucovich, 38 Mont. 188, 99 Pac. 296 (1909); Dodge v. Chapman, 42 Cal. App. 612, 183 Pac. 966 (1919). That the statutes in the two preceding cases are merely codifications of the common law see U. S. Building & Loan Ass'n v. Burns, 4 Pac. (2d) 703 (Mont. 1931).

[6] 1 TIFFANY, LANDLORD AND TENANT (1910), 1055 *et seq.*

[7] In view of the lessor's written statement of intention to hold all parties liable on the original lease, the court seems clearly in error in holding that a surrender of the original lease took place. Miller v. Benton, 55 Conn. 529, 13 Atl. 678 (1887), Higgins v. Street, 19 Okla. 42, 92 Pac. 153 (1907); Note (1908) 13 L. R. A. [N. S.] 398.

[8] In this respect, the assignor of a lease as a surety seems analogous to a corporate, or "compensated," surety for which see ARNOLD, SURETYSHIP AND GUARANTY (1927), 359 *et seq.*

[9] 283 U. S. 273, 51 Sup. Ct. 390 (1931).

The only substantial remaining objection to allowance of the lessor's claim in receivership is a ground advanced by the court that, in executing the new lease, the lessor had not mitigated, but increased the damages. While the court states that the lessor had only to sue the Bayshore Co. for breach of the original lease, it seems clear that such action was not compulsory, inasmuch as the creditor lessor had the option of proceeding against either the assignor or assignee.[10] And since a lease to a third party would clearly be regarded as in mitigation of damages, it seems that a lease to the same tenant is no worse if the obligation, and right of subrogation relating to the original lease, remain intact.[11] In forcing the lessor to rent to a third party or allow the premises to remain vacant, the rule in the instant case imposes considerable hardship, especially since, in a period of falling prices, the lessor will frequently be unable to rent over to a third party premises which are suited to a particular purpose.

Injunction Against Performance of Contract in Absence of Party Thereto

Husting Company v. Coca-Cola Company[1] is illustrative of the possibility of complications attendant upon the rendition of an equitable decree in the absence of an indispensable party. In 1917 the *X* corporation, proprietor of the exclusive right to bottle and sell "Coca-Cola" in Wisconsin, assigned to the *A* corporation, the exclusive bottling rights within *Y* county, *A* promising to purchase an annual minimum of Coca-Cola syrup, and *X* reserving a power to terminate the contract upon breach of *A's* promise. *A's* orders having fallen below the minimum in 1920, *X* attempted to exercise its power to terminate by refusing further shipments to *A*. *A* declared that its failure to perform was excused by *X's* requests to curtail orders during a sugar shortage. In 1923 independent promoters, with knowledge of *A's* contention, organized the *B* corporation, which contracted with *X* for exclusive rights within certain counties in Wisconsin, including *Y* county. Subsequently *B* assigned part of its rights to its subsidiary, the *C* corporation, which began operation within *Y* county. In an action instituted by *A* to enjoin *B* and *C* from inducing a breach of *A's* contract with *X*, *B* and *C* filed a plea in abatement alleging that *X*, a foreign corporation which could not be served and had not voluntarily appeared, was an indispensable party. But the Wisconsin court, conceding that the action necessarily involved a material question concerning *X's* rights, nevertheless held that this fact afforded no valid objection to proceeding to a decree against *B* and *C*, since they, as alleged tort-feasors, were in no position to complain that another joint tort-feasor had not been joined with them. In a subsequent trial on the merits, *A* in *X's* absence successfully demonstrated that *X*, by requesting *A* to curtail orders, had lost the power to terminate its contract with *A*, and that *B* and *C*, by procuring the assignment of bottling rights within *A's* territory, had induced a breach of *X's* contract with *A*. Therefore the court perpetually enjoined *B* and *C* from further operations within *Y* county.[2]

The immediate effect of this injunction is to compel *B* to breach its contract with *X*, in so far as that contract requires *B* to purchase syrup and

[10] In re Tidus, 4 F. (2d) 558 (D. Del. 1925).

[11] If the surety's right to subrogation remains intact, the basic reason for release because of a "new contract" between creditor and debtor is avoided.

[1] 194 Wis. 311, 216 N. W. 833 (1927).

[2] 237 N. W. 85 (Wis. 1931).

bottle Coca-Cola within *Y* county. It is therefore quite possible that *X*, not being a party to the action, and not being bound by the decree, might institute a subsequent action for damages against *B* for *B*'s failure to perform its contract, under the contention that the contract between *X* and *A* was lawfully terminated. Should *X* succeed in its contention, as is not inconceivable in view of the close contest over the issues in the principal case,[3] the question would be presented whether *B*'s duty to pay damages to *X* would be discharged by reason of the Wisconsin injunction. There is respectable authority[4] for the view that impossibility of performance may be caused by a supervening judicial decree, provided that such decree is not induced by the promisor's "contributing fault." "Contributing fault" has in some cases been thought to imply a failure of diligence in procuring a dissolution of the injunction,[5] and might well be extended to include a failure of diligence in notifying the promisee of the pendency of the third party's action against the promisor. It is apparent in the principal case, however, that *B*'s efforts to procure a dissolution of the injunction could not have been more assiduous in view of its motion for rehearing[6] and petition to the United States Supreme Court for certiorari;[7] and it is reasonable to presume that *X* was notified of the pendency of the action against *B* and *C* inasmuch as its officers were present as witnesses at the trial court. The consequent denial of *X*'s right to damages against *B* would indicate the binding effect of the Wisconsin injunction upon *X*, even though entered in its absence. This prejudice to *X* would seem the very evil at which the rule as to the indispensability of parties has been aimed[8]

[3] Additional issues were litigated concerning the relations between *A* and *X*: the sufficiency of *X*'s notice of termination of the contract, the adequacy of *A*'s remedy at law, the effect of *A*'s failure to institute an action against *X*, and of its violation of its covenant not to manufacture or sell imitations of Coca-Cola. It is conceivable that *X*'s evidence on these issues might justify the conclusion that the contract between *A* and *X* was lawfully terminated.

[4] RESTATEMENT OF THE LAW OF CONTRACTS (Am. L. Inst. 1932) c. 14, § 458; 3 WILLISTON, CONTRACTS (1920) § 1939. For the appointment of a receiver as impossibility of performance, see Note (1919) 3 A. L. R. 627.

[5] Peckham v. Industrial Securities Company, 31 Del. 200, 113 Atl. 799 (1921); see Union Contracting & Paving Company v. Campbell, 2 Cal. App. 534, 536, 84 Pac. 305 (1905).

[6] Denied, 238 N. W. 626 (Oct. 29, 1931).

[7] Denied, 52 Sup. Ct. 311 (Feb. 23, 1932). Defendants argued that the Wisconsin court's adjudication of *X*'s rights in its absence, and indirect nullification of the contract between *X* and *B* by means of the Wisconsin injunction, was a taking of property without due process of law. Such an argument, however, would seem a mere restatement in constitutional terms of the contention that *X* was an indispensable party. Denial of the petition was in accord with numerous dicta to the effect that the due process clause does not enable the United States Supreme Court to revise the decisions of state courts on questions of state law, even though they may be contrary to previous decisions. See American Ry. Express Company v. Commonwealth of Kentucky, 273 U. S. 269, 273, 47 Sup. Ct. 353, 354, (1927); Chicago Life Insurance Company v. Cherry, 244 U. S. 25, 30, 37 Sup. Ct. 492, 493 (1917); Patterson v. Colorado, 205 U. S. 454, 461, 27 Sup. Ct. 556, 557 (1907).

[8] For the technical distinction between "necessary" and "indispensable" parties, see Mallow v. Hinde, 12 Wheat. 193, 197 (1827); Shields v. Barrow, 17 How. 130, 139 (1855); Williams v. Bankhead, 19 Wall. 563, 571 (1873);

in cases involving the validity of charters,[9] the disposition of a common fund,[10] or the reformation,[11] rescission,[12] or the setting aside of instruments,[13] where there have been outstanding claims of third parties whose joinder is impossible.

However, older cases intimate that a supervening injunction does not excuse the promisor's performance, on the theory either that the promisor should have contracted against the contingency,[14] or that his performance is not sufficiently "illegalized," [15] as in the case of a supervening prohibitive governmental act. The application of this reasoning to dispose of a subsequent action between *X* and *B*, therefore, would subject *B* not only to the Wisconsin injunction preventing performance, but also to an action for damages at the hands of *X* for failure to perform. Thus to expose *B* to the double liability of conflicting judgments would seem inconsistent with the policy of equity to leave no one exempt from a decree who can later bring forth an inconsistent claim against one of the parties to the original proceedings.[16]

It may well be, however, that the possibility of complications resulting from the absence of *X* as a party to the proceedings in 1927 is somewhat hypothetical in view of the apparent cooperation between *X*, *B* and *C* in presenting evidence to the trial court in 1928.[17] But it is difficult to assume that the court in 1927 could have foreseen such conduct in the 1928 trial. In any event, the decision in the principal case, while it may not entail undesirable consequences in view of the particular circumstances,

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CLARK, CODE PLEADING (1928) 245; CLEPHANE, EQUITY PLEADING (1928) 31-48.

[9] Northern Indiana R. R. Co. v. Michigan Central R. R. Co., 15 How. 233 (1853); California v. Southern Pacific Company, 157 U. S. 229, 15 Sup. Ct. 591 (1895).

[10] Russell v. Clark's Executors, 7 Cranch 69 (U. S. 1812); Williams v. Bankhead, *supra* note 8; Mahr v. Norwich Union Fire Insurance Company, 127 N. Y. 452, 28 N. E. 391 (1891).

[11] Steinbach v. Prudential Insurance Company of America, 172 N. Y. 471, 65 N. E. 281 (1902); see Eustis Manufacturing Company v. Saco Brick Company, 198 Mass. 212, 220, 84 N. E. 449, 452 (1908).

[12] Shields v. Barrow, *supra* note 8.

[13] *Leases.* South Penn Oil Company v. Miller, 175 Fed. 729 (C. C. A. 4th, 1909); Columbia Water Power Company v. Columbia Electric Street Ry. Light & Power Company, 43 S. C. 154, 20 S. E. 1002 (1895). *Contracts.* Leydon v. Owen, 150 Mo. App. 102, 129 S. W. 984 (1910); see Osterhoudt v. Board of Supervisors, 98 N. Y. 239, 244 (1885). *Wills.* Carrau v. O'Calligan, 125 Fed. 657 (C. C. A. 9th, 1903), *aff'd*, 199 U. S. 89, 25 Sup. Ct. 727 (1905) *sub. nom.* Farrel v. O'Brien. *Judicial Sales.* See Hoe v. Wilson, 9 Wall. 501, 503 (1869). *Assignments for benefit of creditors.* First National Bank of Amsterdam v. Shuler, 153 N. Y. 163, 47 N. E. 262 (1897).

[14] Doolittle v. Nash, 48 Vt. 441 (1876); McQuiddy v. Brannock, 70 Mo. App. 535 (1897).

[15] Whittemore v. Sills, 76 Mo. App. 248 (1898); see Klauber v. San Diego Street Car Company, 95 Cal. 353, 357, 30 Pac. 555, 555 (1892).

[16] The following cases were apparently influenced by a fear of a double recovery against the defendant before the court. California v. Southern Pacific Company, *supra* note 9; Mahr v. Norwich Union Fire Insurance Company, *supra* note 10; Steinbach v. Prudential Insurance Company of America, *supra* note 11; Leydon v. Owen, *supra* not 13. But *cf.* Note (1911) 29 L. R. A. (N. S.) 405.

[17] See appellant's brief in opposition to motion for rehearing, at 11 *et seq.*

is representative of some of the dangers that may flow from ignoring the prejudice to an absent party and the defendant before the court in a desire to avoid a total denial of a complainant's equitable relief.[18]

SET-OFF OF CROSS-JUDGMENT AGAINST ASSIGNED JUDGMENT

DEFENDANT had recovered judgment against the plaintiff. Subsequently the plaintiff obtained a judgment against the defendant. Plaintiff now seeks to enjoin defendant's levying execution and to set off her judgment against the defendant's. Prior to plaintiff's recovery of her cross-judgment, defendant's judgment had been assigned, and made subject to attorney's lien, and to protect their respective interests, the assignees and attorneys [1] intervened. The defendant was found to be insolvent, but when he became so is not indicated. The Georgia Supreme Court granted the injunction and set-off.[2] This decision extends the doctrine of set-off of mutual judgments beyond the limits of its application in other jurisdictions and establishes a rule which tends to destroy the marketability of judgments.

Where a cross-judgment is held by the judgment debtor at the time of the assignment, the assignee ordinarily takes subject to a right of set-off on the part of the judgment debtor.[3] In some cases the right to set-off is based primarily on the fact that the assignee knew of the cross-judgment [4] and is denied if he did not [5] or could not know [6] of it. But the usual attitude of the courts is that the element of notice is of no significance and that assignment of the judgment carries the burden of any existing cross-judgment.[7] The rule is the same as that commonly applied to other choses in action.[8] Where, on the other hand, the cross-judgment is recovered after the assignment, there obviously can be no burden existing at

[18] Under analogous circumstances a result similar to that in the principal case has been reached. New York Phonograph Company v. Jones, 123 Fed. 197 (S. D. N. Y. 1903); Alcazar Amusement Company v. Mudd & Colley Amusement Company, 204 Ala. 509, 86 So. 209 (1920); Nokol Company v. Becker, 318 Mo. 292, 300 S. W. 1108 (1927). But see New York Bank Note Company v. Hamilton Bank Note Engraving & Printing Company, 83 Hun 593, 598, 31 N. Y. Supp. 1060, 1064 (Sup. Ct. 1st Dep't 1895). *Cf.* Montgomery Enterprises v. Empire Theatre Company, 204 Ala. 566, 86 So. 880 (1920); Note (1930) 69 A. L. R. 1038.

[1] Under the Georgia decisions attorneys with lien are treated as bona fide assignees. Caudle v. Rice, 78 Ga. 81 (1886).

[2] Odom v. Attaway, 173 Ga. 883, 162 S. E. 279 (1931). *Accord:* Langston v. Roby, 68 Ga. 406 (1882); Smith v. Evans, 110 Ga. 536, 35 S. E. 633 (1900).

[3] Brown v. Hendrickson, 39 N. J. L. 239 (1877); Filbert v. Hawk, 8 Watts 443 (Pa. 1839); *cf.* McBride v. Fallon, 65 Cal. 301, 4 Pac. 17 (1884).

[4] Skinker v. Smith, 48 Mo. App. 91 (1892); Wabash Railroad Co. v. Bowring, 103 Mo. App. 158, 77 S. W. 106 (1903); Nuzum v. Morris, 25 W. Va. 559 (1885).

[5] Ames v. Bates, 119 Mass. 397 (1876); Mervine v. Greble, 2 Pars. Eq. 271 (Pa. 1849); Davidson v. Lee, 162 S. W. 414 (Tex. Civ. App. 1913).

[6] Simmons v. Reid, 31 S. C. 389, 9 S. E. 1058 (1889); Heston v. Finley, 118 Kan. 717, 236 Pac. 841 (1925).

[7] Brown & Bro. v. Lapp, 89 S. W. 304 (Ky. 1905); Rowe v. Langley, 49 N. H. 395 (1870); Chamberlin v. Day, 3 Cow. 353 (N. Y. 1824); see Graves v. Woodbury, 4 Hill 559, 561 (N. Y. 1843).

[8] DeLaval Separator Co. v. Sharpless, 134 Iowa 28, 111 N. W. 438 (1907); Brown & Bro. v. Lapp, *supra* note 7.

the time of the assignment which can attach as a set-off. In certain situations, however, courts have permitted the set-off of subsequently obtained cross-judgments.[9] This result is uniformly reached both where the assignment was made fraudulently in order to defeat a possible later set-off,[10] and where the assignor was insolvent at the time of the assignment.[11] And while there is a good deal of authority to the contrary, some courts have permitted set-offs in cases where the claim which later served as the basis for the cross-judgment was in existence at the time of the assignment,[12] or where the judgment debtor procured his judgment subsequently to the assignment but prior to notice of that assignment.[13]

In the instant case the cross-judgment arose after the assignment of the first judgment. It is therefore difficult to see upon what ground set-off was allowed since it does not appear that the facts bring the case within any of the above mentioned situations. There is no indication that the assignment was made fraudulently or that plaintiff obtained her cross-judgment prior to notice of assignment. Nor does it seem that the claim upon which plaintiff's cross-judgment is based existed at the time of the assignment. If the court intended to rest the decision upon the defendant's insolvency, it is peculiar that no mention is made of the time when it occurred.[14] It is true that the court regarded the case as controlled by

[9] For a somewhat similar extension of set-off in the case of claims, see Note (1922) 31 YALE L. J. 669.

[10] Hobbs v. Duff, 23 Cal. 596 (1863); Morris v. Hollis, 2 Harr. 4 (Del. 1835); Crecelius v. Bierman, 72 Mo. App. 355 (1897); Duncan v. Bloomstock, 2 McCord 318 (S. C. 1823); Trammell v. Chamberlain, 60 Tex. Civ. App. 238, 128 S. W. 429 (1910); see Hovey v. Morrill, 61 N. H. 9, 13 (1881).

[11] Tuscumbria, etc., R. R. Co. v. Rhodes, 8 Ala. 206 (1845); Coonan v. Loewenthal, 147 Cal. 218 81 Pac. 527 (1905); Whitehead v. Jessup, 7 Colo. App. 460, 43 Pac. 1042 (1896); Hovey v. Morrill, 61 N. H. 9 (1881); *cf.* Hurst v. Sheets & Trussell, 14 Iowa 322 (1862); Merrill v. Souther, 6 Dana 305 (Ky. 1838); Gay v. Gay, 10 Paige 369 (N. Y. 1843); see Sellers v. Bryan, 17 N. C. 358, 359 (1833).

[12] Arp v. Blake, 63 Cal. App. 362, 218 Pac. 773 (1923); DeLaval Separator Co. v. Sharpless, 134 Iowa 28, 111 N. W. 438 (1907); McIntosh v. McIntosh, 211 Iowa 750, 234 N. W. 234 (1931); Clark v. Raison, 126 Ky. 486, 104 S. W. 342 (1907); New Haven Copper Co. v. Brown, 46 Me. 418 (1859); McManus v. Cash & Luckel, 101 Tex. 261, 108 S. W. 800 (1908). *Contra*: Ledyard v. Phillips, 58 Mich. 204, 24 N. W. 551 (1885); Holly v. Cook, 70 Miss. 590, 13 So. 228 (1893); McAdams v. Randolph, 42 N. J. L. 332 (1880) (judgment rather than claim); Roberts v. Carter, 38 N. Y. 107 (1868); Jaeger v. Koenig, 33 Misc. 82, 67 N. Y. Supp. 172 (1900); Anglo-American Provision Co. v. Davis Provision Co., 112 Fed. 574 (S. D. N. Y. 1902) (citing the New York rule; with which *cf.* Wyckoff v. Williams, *infra* note 13).

[13] Haskins v. Jordan, 123 Cal. 157, 55 Pac. 786 (1898); Wyckoff v. Williams, 136 App. Div. 495, 121 N. Y. Supp. 189 (1st Dep't 1910); Townsend v. Quinan, 47 Tex. 1 (1877). *Contra:* Pheiffer v. Harris, 74 Ky. 400 (1875) (with which *cf.* Clark v. Raison, *supra* note 12). In the following cases also set-offs have been denied because the cross-judgment was not in existence at the time of the assignment: Wyvell v. Barwise, 43 Minn. 171, 45 N. W. 11 (1890); Walton v. Catron, 125 Mo. App. 501, 102 S. W. 1058 (1907); Laubsch v. West New York Silk Mill Co., 57 N. J. L. 234, 30 Atl. 550 1894); Ramsey's Appeal, 2 Watts 228 (Pa. 1834); Hyde v. Gearhart, 44 S. D. 217, 183 N. W. 114 (1921).

[14] Insolvency must have existed at the time of the assignment, or set-off

certain statutory provisions.[15] But it is difficult to see in what way these provisions compelled the decision reached, for in phraseology and apparent meaning, they are not dissimilar from those of other states which are regarded[16] as not having materially changed the doctrine of set-off, a doctrine that existed and still exists independent of statute.[17]

CHANGES IN FORM OF BUSINESS UNIT WITHIN BULK SALES ACTS

THE bulk sales laws,[1] studied in their historical and commercial background,[2] seem to provide a device supplementary to the common law remedy against fraudulent conveyances. Creditors, prejudiced by unannounced sales or transfers by retailers[3] of goods in bulk which themselves often served as the basis of the credit extension, could only preserve their rights by proving mutual fraudulent intent;[4] and proof of fraud was an exceedingly difficult task. Bulk sales laws of two general types declare these transactions either fraudulent and void or presumptive of fraud in the absence of performance of certain acts calculated to give creditors notice in time to protect themselves or to insure a fair sale.

A question as to the applicability of the bulk sales statutes arises when there is a transfer by an individual or business unit to another individual or business unit that continues the old concern through a different entity. The Pennsylvania court has recently held that a transfer of assets by an individual to a corporation formed by him is outside the application of the State Act.[5] In other cases involving transfers by individuals to corporations,[6] partnerships to corporations,[7] and corporations to corporations,[8] where the principal parties of both the old and new units remain substantially the same, a contrary result has been reached. A mere transmutation of the business with an apparent purpose of defeating creditor's claims

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will be denied. Henderson v. McVay, 32 Ala. 471 (1858): Robbins v. Holley, 1 Mon. 191 (Ky. 1824); see *supra* note 11.

[15] GA. CODE ANN. (Michie, 1926) §§ 5670, 5969.

[16] Haskins v. Jordan, 123 Cal. 157, 55 Pac. 786 (1898); 2 Freeman Judgments (5th ed. 1925) § 1142.

[17] Haskins v. Jordan, *supra* note 16; Pierce v. Bent, 69 Me. 381 (1879); Chase v. Woodward, 61 N. H. 79 (1881); 2 Freeman, *loc. cit. supra* note 16. Both law and equity courts have this inherent power to set off cross-judgments. Hovey v. Morrill, 61 N. H. 9 (1881); Nuzum v. Morris, 25 W. Va. 559 (1885).

[1] For list of statutes in various states see Billig, *Bulk Sales Laws: A Study In Economic Adjustment* (1928) 77 U. OF PA. L. REV. 72, footnotes 3, 5, 6, 7, 8, 9, 10.

[2] For a good account of the development of this type of legislation, see Billig, *supra* note 1.

[3] For a list of cases dealing with the practice these statutes were called upon to meet, see Billig, *supra* note 1, footnote 18.

[4] See 12 R. C. L. 533-536.

[5] McLean v. Miller Robinson Co., 55 F. (2d) 232 (E. D. Pa. 1931).

[6] Kline v. Sims, 149 Miss. 154, 114 So. 871 (1927).

[7] N. Sakelos & Co. v. Hutchinson Bros., 129 Md. 300, 99 Atl. 357 (1916).

[8] First National Bank v. Raleigh Savings Bank & Trust Co., 37 F. (2d) 301 (C. C. A. 4th, 1930). There is some ground for believing that a transfer of assets by an old corporation to the new corporation in reorganization might come under the bulk sales acts. *Cf.* Reilly v. Allen-Spiegal Shoe Manufacturing Co., 184 Wis. 257, 199 N. W. 216 (1924).

clearly seems to come within the scope of both types of the statute.[9] When the statute makes the transaction only presumptively fraudulent and void[10] it is possible to uphold a transfer by a partnership to a successor corporation by proving absence of actual fraud.[11] But a conflict appears where the act flatly makes the transaction fraudulent or void.[12] The language of several cases[13] indicates automatic application of the act without decision as to the presence of active or intended fraud. In contradiction to this policy, the Washington court[14] looked behind the act and refused to apply it where the "reason" for its passage was not present; it determined that the particular transfer of the individual to the corporation was not fraudulent, inasmuch as there was an available remedy in a levy on the capital stock of the corporation given in return for the goods. The absence of any fraud in the recent Pennsylvania case[15] justifies the result in the light of this policy. However, the decision may be less sound in its apparent emphasis upon the theory[16] that an exchange for capital stock does not constitute a transfer for "cash or credit" within the statute, rather than upon the actual presence of fraud in the particular situation. The Washington court avoided the danger of this technical construction, declaring that any manipulation of the stock so as to deprive the creditors of a remedy would not be countenanced.[17] Apparently the ends of justice will theoretically be served by either automatic or deliberative application of the statute. The correctness of either method seems to depend upon the "reason" for the statute. If the act was aimed only at the fraudulent transactions, a deliberative application is in order. But if the statute was intended as a reason-

[9] West Shore Furniture Co. v. Murphy, 141 N. Y. Supp. 835 (Sup. Ct. 1913); Kline v. Sims, *supra* note 6.

[10] For a classification of statutes with discrimination of states having this type, see Thorpe v. Pennock Mercantile Co., 99 Minn. 22, 108 N. W. 940 (1906).

[11] Thorpe v. Pennock Mercantile Co., *supra* note 10; *cf.* Norton-Berger Shoe Co. v. Rideau, 1 La. App. 244 (1924).

[12] For list of states, see *supra* note 10.

[13] Smith-Calhoun Rubber Co. v. McGhee Rubber Co., 235 S. W. 321 (Tex. Civ. App. 1921); N. Sakelos & Co. v. Hutchinson Bros., *supra* note 7.

[14] Maskell v. Spokane Cycle & Auto Supply Co., 100 Wash. 16, 170 Pac. 350 (1918).

[15] McLean v. Miller Robinson Co., *supra* note 5. The court decided that there was no fraud. Actually the individual formed a corporation and transferred his assets to it because he could thereby get a receiver appointed for the corporation which would secure equal distribution of his assets and defeat the objecting creditor who had wanted to get in his full claim by way of attachment. For the litigation dealing with this other angle, see Shapiro v. Wilgus, 55 F. (2d) 234 (C. C. A. 3d, 1931). To have applied the statute would have only made the corporation a receiver for the creditors and would not have given the protesting creditor any preference. 69 PA. STAT. (1919) § 521–523.

[16] The Maskell case, *supra* note 14, only mentions this construction of the act, seeming to place its major emphasis on the purpose of the act in relation to the particular case. The McLean case, *supra* note 5, makes it the main basis of decision, neglecting to emphasize the actual motives of the debtor and results to the creditors.

[17] Two other cases substantiate this reservation by holding the act applicable when the transfer by the old unit to the new corporation was followed by a manipulation of the stock so as to defeat creditors. First National Bank v. Raleigh Savings Bank & Trust Co., *supra* note 8; West Shore Furniture Co. v. Murphy, *supra* note 9.

able exercise of police power applying to all such transfers because of the abundant and exceptional opportunities for fraud, then an automatic application is proper.

Turning to (1) sales by merchants to outsiders to form a partnership, and (2) sales by partners to co-partners, slightly different considerations appear. The first situation is generally placed within the act[18] for varying reasons. One consideration[19] is the possibility of economic prejudice to the individual creditors of the seller, in that after the sale, they may have rights against only one-half of the stock[20] instead of the whole. Even when this objection has been obviated through contribution by the incoming partner of an equivalent share of the goods to the new firm, the same result has been reached by stating that the transaction was "outside the usual course of business."[21] Another court, assuming that the transfer by a partner to a co-partner might be upheld,[22] reasoned that non-application to the first type would defeat the statute completely by allowing the individual to sell one-half interest in his goods one day to form a partnership and the other one-half interest to his partner the next.[23]

In the case of a transfer by a partner to a co-partner,[24] the majority rule of non-application of the statute is supported on the theories that the statute is in derogation of the common law and tends to restrain liberty of contract and therefore should be strictly construed;[25] that the act is remedial and should be liberally construed but there is no physical delivery nor change in actual or legal possession[26] as is contemplated by the act; that there is no actual prejudice to creditors.[27] The minority view[28] is

[18] Daly v. Sumpter Drug Co., 127 Tenn. 412, 155 S. W. 167 (1913); Marlow v. Ringer, 79 W. Va. 568, 91 S. E. 386 (1917); Va-Carolina Chemical Co. v. Bouchelle, 12 Ga. App. 661, 78 S. E. 51 (1913); Watkins v. Angus, 241 Mich. 690, 217 N. W. 894 (1928).

[19] Daly v. Sumpter Drug Co., *supra* note 18.

[20] After the partnership is formed the creditors of the individual seller have a right only against his present interest in the partnership profits and surplus on winding up, which, assuming he had sold one-half interest would be only one-half of the goods, assuming no partnership debts. UNIFORM PARTNERSHIP ACT, § 26. In the meantime the personal creditors of the seller cannot levy against the partnership property. UNIFORM PARTNERSHIP ACT, § 25 (c). They may subject the debtor partner's interest to a charging order against his share of the profits. UNIFORM PARTNERSHIP ACT, § 28 (1).

[21] Marlow v. Ringer, *supra* note 18.

[22] Va-Carolina Chemical Co. v. Bouchelle, *supra* note 18.

[23] See Watkins v. Angus, *supra* note 18.

[24] Note (1931) 5 UNIV. OF CINN. L. REV. 91; (1926) 75 U. OF PA. L. REV. 787; (1926) 11 MINN. L. REV. 668.

[25] Taylor v. Folds, 2 Ga. App. 453, 58 S. E. 683 (1907); Fairfield Shoe Co. v. Olds, 176 Ind. 526, 96 N. E. 592 (1911).

[26] Schoeppel v. Pfannensteil, 122 Kan. 630, 253 Pac. 567 (1927). The court based its theory on the idea that each partner had an interest in the whole and that the sale of this interest was not a change in the purchasing partner's actual ownership since he already owned an interest in the whole. Conversely that the seller partner owned no property specifically and his sale was only of an interest in the partnership and not any particular stock or bulk. No doubt its basis of reasoning is the corresponding theory in partnership law. UNIFORM PARTNERSHIP ACT, § 25 (1) and (2) (a); MECHEM, ELEMENTS OF PARTNERSHIP (2d ed. 1920) § 146.

[27] The court reasons that the partnership creditors are not prejudiced as to the goods since they are physically and legally as accessible as before. Personal creditors of the selling partner are not considered because they

based on the argument that the interest of the partnership creditors will be prejudiced since the stock of goods would be subject to levy and claim by personal creditors of the purchasing partner after the transfer, whereas prior to the transfer, the partnership creditors had to be paid before the satisfaction of any personal creditors.[29] There is a prejudice to the personal creditors of the selling partner in that they lose their right to a charging order on his interest[30] or to his share of the surplus on winding up.[31] There is doubt, however, as to whether the personal creditors of the selling partner will be considered.[32] Any estimate of the relative merit of these conflicting views involves a choice between a strict logical construction of the statute based upon the legal nature of a partner's interest and a realistic decision grounded upon the possibility of economic prejudice to the creditors.[33]

ENTRAPMENT AS DEFENSE IN PROSECUTION FOR PROHIBITION VIOLATION

BEFORE the advent of the National Prohibition Act the defense of entrapment was normally available to a defendant who could show that he had been incited and induced to violate the law by an agent of the government.[1] The attitude of the federal courts in the early days of Prohibition toward such conduct on the part of officers of the government is well shown in the case of *United States v. Echols*[2] where, upon evidence of improper induce-

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cannot look *directly* to the partnership goods. For an evaluation of these views, see footnotes 29 and 30 *infra*.

[28] Howell v. Howell, 142 Tenn. 31, 215 S. W. 278 (1919); In re Strobel, 43 F. (2d) 179 (W. D. Ark. 1930). In the latter case the claim of the selling partner on notes given in payment was barred in bankruptcy because the notes were given without compliance with the bulk sales act. If the plaintiff's claim had been allowed, the claims of the partnership would be reduced by the amount of the payments made to the partner who got out.

[29] The court does not go any farther in explaining this prejudice. Although the compliance with the bulk sales law would not prevent this latter prejudice, compliance with it would give the partnership creditors notice of the sale beforehand instead of afterwards by the notice of the dissolution. MECHEM, ELEMENTS OF PARTNERSHIP (2d ed. 1920) § 364, § 391. This notice beforehand would give the creditors additional opportunities to protect themselves from any dangers to their standing that the change in the partnership status might entail.

[30] UNIFORM PARTNERSHIP ACT, § 28.

[31] UNIFORM PARTNERSHIP ACT, § 26.

[32] Garner v. Thompson, 161 Wash. 317, 296 Pac. 1043 (1931). Statute did not require in sale of a partnership that personal creditors of partners be listed. This raises the problem as to whether they can be considered.

The objection of a personal creditor on bulk sales act was overruled in The Peterson Co. v. Freeburn, 204 Iowa 644, 215 N. W. 746 (1927), because the indirect nature of his claim against partnership interest, *supra* note 22, refutes an argument that he advanced credit in strength of that interest.

[33] The sale of an interest in an already existing partnership to an outsider, with the retirement of one partner, was exempted from the application of the statute. Yancey v. Lamar-Rankin Drug Co., 140 Ga. 359, 78 S. E. 1078 (1913). The personal creditors are apparently the only ones prejudiced in this transaction. The economic soundness of the decision depends upon the determination as to whether they may be considered.

[1] Woo Wai v. United States, 223 Fed. 412 (C. C. A. 9th, 1915); Sam Yick v. United States, 240 Fed. 60 (C. C. A. 9th, 1917).

ment by the prosecuting officer, the court refused to accept the defendant's plea of guilty and dismissed the case. A great change from this attitude is found in one circuit at least, after fourteen years of attempted enforcement of the prohibition law, in the recent case of *Sorrels v. United States*[3] where inducement and persuasion by the prohibition officer are wholly denied as a defense. In this case the officer procured his introduction to the defendant as a furniture dealer on vacation, "desirous of purchasing some good whiskey." The defendant stated that he did not have any whiskey and "did not fool with it." After a visit of an hour and a half, however, during which it developed that the two had served together in the same division of the army during the World War, and after repeated requests for whiskey from his former comrade in arms, the defendant finally agreed that he would "see if he could get some." After an absence of less than half an hour he returned with whiskey which he sold to the officer. Upon evidence to this effect, the court refused to submit the issue of entrapment to the jury, holding that this defense may be pleaded only where, as a result of the inducement, the accused is placed in the position of having committed a crime which he did not intend to commit,[4] or where the consent implied in the inducement is such as to negative the offense.[5]

Although, obviously, an officer who purchases intoxicants from a bootlegger thereby connives with him at his crime, it is nevertheless very generally agreed that mere consent on the part of the officer to the illegal sale is no defense to the seller.[6] Moreover, deliberate plans laid by prohibition officers which merely afford an opportunity for suspected persons to violate the law do not constitute entrapment which may be pleaded in defense.[7] It has been repeatedly held, however, that while such opportunities may be offered,[8] and while officers themselves may offer to buy,[9] they may not persuade or induce violations of the law.[10] Exceptions have been made, and a certain amount of encouragement and persuasion allowed where complaint has been lodged against the defendant,[11] or where there was other reason

[2] 253 Fed. 862 (S. D. Tex. 1918).

[3] U. S. Daily, April 29, 1932, at 394 (C. C. A. 4th, 1932).

[4] *E. g.*, cases of mistaken identity, such as selling liquor illegally to Indians who had been disguised by government officials to conceal their identity (when sales to others than Indians were legal). United States v. Healy, 202 Fed. 349 (D. Mont., 1913); Voves v. United States, 249 Fed. 191 (C. C. A. 7th, 1918).

[5] *E. g.*, as in larceny or burglary. See United States v. Whittier, Fed. Cas. No. 16,688 (C. C. E. D. Mo. 1878).

[6] Jordan v. United States, 2 F. (2d) 598 (C. C. A. 5th, 1924). See cases cited *infra* notes 7, 8, and 9.

[7] Smith v. United States, 284 Fed. 673 (C. C. A. 8th, 1922), *cert. den.* 261 U. S. 617, 43 Sup. Ct. 362 (1923); Zucker v. United States, 288 Fed. 12 (C. C. A. 3d, 1923) *cert. den.* 262 U. S. 756, 43 Sup. Ct. 703 (1923).

[8] Ritter v. United States, 293 Fed. 187 (C. C. A. 9th, 1923); Swallum v. United States, 39 F. (2d) 390 (C. C. A. 8th, 1930).

[9] Farley v. United States, 269 Fed. 721 (C. C. A. 9th, 1921); Ritter v. United States, *supra* note 8.

[10] Billingsley v. United States, 274 Fed. 86 (C. C. A. 6th, 1921), *cert. den.* 257 U. S. 656, 42 Sup. Ct. 168 (1921); Leon v. United States, 290 Fed. 384 (C. C. A. 9th, 1923), *cert. den.* Trueba v. United States, 263 U. S. 710, 44 Sup. Ct. 37 (1923); O'Brien v. United States, 51 F. (2d) 674 (C. C. A. 7th, 1931); (1931) 45 HARV. L. REV. 381.

[11] Fetters v. United States, 260 Fed. 142 (C. C. A. 9th, 1919), *cert. den.* 251 U. S. 554, 40 Sup. Ct. 119 (1919); Corcoran v. United States, 19 F. (2d) 901, (C. C. A. 8th, 1927).

for the officer to believe that the defendant was an habitual offender.[12] Some persuasion has been permitted merely in way of giving reasons in an offer to buy—for example, that the liquor was wanted for sickness.[13] The generally accepted test of entrapment is the determination of whether the defendant would have committed the offense at all, with the officer or with anyone else, had he not been subjected to the particular solicitation and persuasion by the officer; [14] and this is of course a matter of fact for the jury. Though it has apparently not been so stated, the question here seems to be, did the officer resort to more urgent persuasion than a bona fide customer of a bootlegger would reasonably have done, due allowance being made for natural caution in making an initial sale to a new customer. The principle is apparently accepted that while the officer may play an ignoble or unethical role in detecting crime,[15] he may not incite and produce crime which would not otherwise have existed.[16] The principle case here considered, by refusing to submit the issue of entrapment to the jury upon evidence of aggravated inducement,[17] appears to take the extreme position of legalizing, so far as persuasion may be employed to that end, the inciting and producing of crime by government officers for the purpose of punishing it.

This decision is, of course, not binding upon other circuits, which continue to be governed by rules of their own making, generally to the effect suggested above.[18] The Supreme Court has repeatedly denied certiorari on entrapment cases,[19] preferring, evidently, that each circuit make its own rule. It has, however, in *Olmstead v. United States*,[20] passed upon the larger question of government approval of unethical conduct on the part of its officers in criminal prosecutions. Overruling its former stand of disowning, on behalf of the government, the products of illegality [21] or stealth [22] on the part of its officers when presented as evidence in criminal prosecutions,

[12] United States v. Certain Quantities of Intoxicating Liquors, 290 Fed. 824 (D. N. H. 1923); Rossi v. United States 293 Fed. 896 (C. C. A. 8th, 1923); Swallum v. United States, *supra* note 8.

[13] Goldstein v. United States, 256 Fed. 813 (C. C. A. 7th, 1919).

[14] Butts v. United States, 273 Fed. 35 (C. C. A. 8th, 1921); Newman v. United States, 299 Fed. 128 (C. C. A. 4th, 1924). See *infra* note 16.

[15] Olmstead v. United States, *infra* note 20; O'Brien v. United States, *supra* note 10, where prohibition agents operated a "speak-easy" for the purpose of selling liquor to policemen.

[16] Butts v. United States, *supra* note 14; Luterman v. United States, 281 Fed. 374 (C. C. A. 3d, 1922); O'Brien v. United States, *supra* note 10. See United States v. Pappagoda, 288 Fed. 214 (D. Conn. 1923) for a very thorough analysis of entrapment cases prior to that date.

[17] Where there is evidence of entrapment the issue of fact must be submitted to the jury. Jarl v. United States, 19 F. (2d) 891 (C. C. A. 8th, 1927).

[18] Recent cases holding, *contra* to the principal case, that inducement by government officers constitutes entrapment: Silk v. United States, 16 F. (2d) 568 (C. C. A. 8th, 1926); Ybor v. United States, 31 F. (2d) 42 (C. C. A. 5th, 1929); Vaccaro v. Collier, 38 F. (2d) 862 (D. Md. 1930); O'Brien v. United States, *supra* note 10. Many other cases have so declared the law since the enactment of the National Prohibition Act, including Newman v. United States, *supra* note 14, decided in 1924 by the same court which decided the principal case, and expressly overruled by the latter.

[19] See *supra* notes 7, 10, and 11.

[20] 277 U. S. 438, 48 Sup. Ct. 564 (1928).

[21] Weeks v. United States, 232 U. S. 383, 34 Sup. Ct. 341 (1914).

[22] Gouled v. United States, 255 U. S. 298, 41 Sup. Ct. 261 (1921).

it admitted by a vote of five to four evidence for the government obtained by prohibition enforcement agents through wire-tapping, in violation of the laws of the state where it occurred. The issue in that case between greater facility in convicting criminals on the one hand and the loss of respect for a government which comes into court with unclean hands on the other, clearly set out in the four dissenting opinions,[23] is fundamentally the issue here. To just what extent actual punishment deters crime, it can probably never be known. There is, however, a persistent feeling prevalent today that a high and respectful regard for the probity and integrity of the government itself, epitomized in standards set for it in its courts of justice, is of no small importance in inducing obedience to its laws.[24] In the words of Holmes' dissent in the above cases: [25] "We have to choose, and for my part I think it a less evil that some criminals should escape than that the Government should play an ignoble part." [26]

Power of State Banking Commissioner to Pledge Assets to Reconstruction Finance Corporation

In the recent case of *Riches v. Hadlock*,[1] the Utah Banking Commissioner, empowered by state statute, took possession of the insolvent Sugar Banking Co., paid off certain obligations, and then applied to the district court for an order directing him to pledge the assets of the bank to secure a two year loan from the Reconstruction Finance Corporation. The purpose of the loan was in harmony with the theory of the Reconstruction Finance Corporation,[2] namely, to delay liquidation of abnormally deflated assets and at the same time to pay dividends to depositors in order to relieve their immediate need. The order was granted, but at the instance of a depositor-stockholder, the Utah Supreme Court issued a writ of prohibition to the lower court on the grounds that the power thus to pledge assets was not set out in the statute, and that since the Banking Commissioner was a state officer deriving his powers from the statute, the court had no jurisdiction to enlarge those powers.

Statutes thus centralizing the control of state banks through the appointment of an administrative officer with variously defined duties and powers exist in practically every state.[3] The result is to bring a higher quality of

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[23] See particularly the dissenting opinions of Justices Brandeis and Holmes.

[24] See Arnold, *The Role of Substantive Law and Procedure in the Legal Process* (1932) 45 Harv. L. Rev. 617, 640 *et seq.*

[25] *Supra* note 20, at 470, 48 Sup. Ct. at 575.

[26] That such "ignoble" activity on the part of the government may not only violate the canons of public decency, but also lead to the conviction of innocent persons through perjured testimony of criminals or degenerates employed by the government as "stool pigeons," was clearly shown in the recent vice squad investigations in New York. See People v. Tait, 255 N. Y. Supp. 455 (App. Div. 1st Dep't 1932); Borchard, Convicting the Innocent: *Icie Sands* (1932) at 357.

[1] U. S. Daily, May 7, 1932, at 450.

[2] 11 Cong. Digest 55 (Feb. 1932); *First Quarterly Report of Reconstruction Finance Corporation*, Fed. Reserve Bull., April, 1932, at 226.

[3] Illustrative Statutes: Ala. Code (Michie, 1928) § 6306; Fla. Comp. Laws (1927) § 6102; Ga. Code Ann. (Michie, 1926) § 2366; Ky. Stat. (Carroll, 1930) §§ 165a-15-16.

technical training to small banks,[4] and to avoid the expense of a separate receiver for each bank. In no case, however, are the duties of receivership completely taken over by the statutory officer. In some jurisdictions he merely initiates the proceedings, leaving the remainder of the process to be carried out by the court; [5] in others, he may carry to completion the liquidation of the assets, subject to the possibility that for certain purposes, a chancery receiver may be appointed.[6]

Clearly, the Utah statute falls into the latter group.[7] According to its terms, the Banking Commissioner, upon one of nine contingencies (including insolvency), may take possession of the bank's assets, perform certain matters of routine, liquidate the assets, and do all else necessary to preserve the assets. The statute provides, however, for the appointment of a chancery receiver "when necessary to preserve the assets." It is therefore possible that the refusal of the court liberally to construe the statute resulted from its reluctance to place such power over the assets of an insolvent bank in the hands of a political officer. If so, the denial of the Commissioner's power to pledge the assets of an insolvent bank to secure a loan from the Finance Corporation may mean only that its exercise is restricted to court officers.

Again, the court may have been unwilling to construe the powers of the bank commissioner to include borrowing on the assets of an insolvent bank, because of the business policy that an insolvent bank ought not to encumber its assets further, but should liquidate them as quickly as possible.[8] The basis for such a policy is the possibility of fraud and mismanagement involved in dragging out the liquidation, and the likelihood that assets might thereby become further impaired.[9] This same mistrust of delay in the closing up of tottering concerns has been reflected in recent Supreme Court opinions with reference to consent receiverships.[10] It should be noted, however, that even in cases which state the proposition that liquidation of an insolvent concern should not be delayed, there is a tendency to relax the rule of caution and to permit the receiver to borrow on the assets in the presence of special circumstances so long as the hypothecation is part of an ultimate process of liquidation.[11] The situation has been likened to the pledging of assets by an insolvent quasi-public corporation to secure receivers' cer-

[4] Spahr, *Bank Failures in the United States* (Supp. 1932 22 AM. EC. REV. 214.

[5] Illustrative statutes: N. H. PUB. LAWS (1926) C. 268, § 4; N. Y. CONSOL. LAWS (Cahill, 1930 c. 3, § 10; TEX. STAT. (1928) § 342.

[6] Illustrative statutes: MINN. STAT. (Mason, 1927) § 5323; KY. STAT. (Carroll, 1930) §§ 165a-15-16; WASH. COMP. STAT. (Remington, Supp. 1927) §§ 3269, 3270; W. VA. CODE (1931) c. 31, art. 8, § 30; KAN. REV. STAT. ANN. (1923) c. 75 § 1301.

[7] UTAH COMP. LAWS (1917) c. 23.

[8] 3 MICHIE, BANKS AND BANKING; In re Union Bank of Brooklyn, 96 Misc. 299, 161 N. Y. Supp. 29 (1916).

[9] In re Union Bank of Brooklyn, *supra* note 8; Buchanan v. Hicks, 98 Ark. 370, 136 S. W. 177 (1911); Broussard v. Mason, 187 Mo. App. 281, 173 S. W. 698 (1915); Hooper v. Winston, 24 Ill. 353 (1860).

[10] Harkin v. Brundage, 276 U. S. 36, 52, 54, 48 Sup. Ct. 268, 274, 275 (1927); Kingsport Press v. Brief English Systems, 54 F. (2d) 497, 499, 500 (1932); see People v. Michigan Trust Company, U. S. Daily, May 17, 1932, at 517.

[11] The Bank of Montreal v. Chicago C. C. and W. Ry. Co., 48 Iowa 518 (1878); Heffron v. Rice, 149 Ill. 216, 36 N. E. 562 (1894); Cake v. Mohun 164 U. S. 311, (1896); Haines v. Buckeye Wheel Company 224 Fed. 289 (1915); Nichols Vigilante v. Old South Trust Company, 251 Mass. 385, 146 N. E. 670 (1925).

tificates.[12]

The basis for the rule of no hypothecation hardly seems applicable to the *Sugar Banking Co.* case: the delay is confined definitely to five years at the end of which the Finance Corporation loan must be met; the depositors are meanwhile relieved of immediate need because money so secured is distributed among them; and the possibility for fraud and mismanagement is minimized by the close scrutiny given by the Reconstruction agency to each loan and its application. Moreover, the abnormally deflated market would seem to be a circumstance justifying the allowance of hypothecation until market conditions improve.

The implications of the decision become more apparent when it is realized that over half the states have statutes sufficiently similar to those in Utah to give rise to the problem of the present case.[13] If this case is followed, the Reconstruction Finance Corporation as an emergency agency will encounter a formidable obstacle in the way of an important phase of its work.

[12] 1 TARDY'S SMITH ON RECEIVERS (2d ed. 1920) § 44.

[13] Alabama, Arizona, Arkansas, California, Colorado, Georgia, Delaware, Louisiana, Massachusetts, Michigan, Minnesota, Missouri, Montana, Nevada, New Hampshire, North Dakota, New Mexico, North Carolina, Ohio, Oregon, Pennsylvania, South Dakota, Washington, Wisconsin.